



The Business Council For Sustainable Energy

An Energy Agenda for the 21st Century

June 21, 2007

To: **Winston Hickox**
Chairman, Cal EPA Market Advisory Committee

Lawrence H. Goulder
Vice Chair, Cal EPA Market Advisory Committee

Regarding: **BCSE Comments on the Market Advisory Committee's Recommendations For Designing a Greenhouse Gas Cap-and-Trade System for California**

Submitted Via Email: **climatechange@calepa.ca.gov**

On behalf of the members of the Business Council for Sustainable Energy (the Council), we appreciate the opportunity to provide comments on the Market Advisory Committee's (MAC), "Recommendations For Designing a Greenhouse Gas Cap-and-Trade System for California," (draft report). As the MAC looks to finalize the draft report's recommendations for the California Air Resources Board (CARB) by June 30, 2007, the Council is pleased to submit the following recommendations for consideration, building upon the Council's prior submission in May 2007.

Introduction

The Business Council for Sustainable Energy is a broad-based industry coalition of energy efficiency, natural gas and renewable energy interests that advocates energy and environmental policies that promote markets for clean, efficient and sustainable energy products and services. The Council's coalition includes power developers, equipment manufacturers, independent generators, green power marketers, and gas and electric utilities, as well as several of the primary trade associations in these sectors. We have several members who are based in California as well as others that are very active in the state's markets and clean energy activities including Sempra Energy, PG&E, PPM Energy, SMUD, First Environment, GE Wind, Calpine, 3 Phases Energy Services, Enel North America, and Solar Turbines.

The Council and its members have been working for many years with state, federal and international policymakers on market-based measures to reduce greenhouse gas emissions. The Council was the first industry coalition to support a binding multilateral regime to address climate change. The coalition supports the establishment of market-based programs for clean energy technology innovation, economic efficiency and enhanced energy security. We view AB 32 as an important vehicle to reduce greenhouse gas emissions and create a workable market-based program in California.

BCSE Comments on MAC Draft Report

In the Council's previous comments submitted in May 2007, the Council made the following recommendations for designing California's greenhouse gas cap-and-trade program:

- Consider market-based design elements holistically
- Promote clean generation and energy efficiency through allocation policy
- Adopt updating, output-based allocation policy
- Establish set-aside allowance pools for small and clean generators, energy efficiency projects and new entrants
- Use auction revenue to reduce program costs by catalyzing clean energy technology investment
- Avoid undue economic hardship on affected sources through allocation decisions
- Grant credit for early action
- Include offsets for compliance flexibility
- Create links between trading systems
- Support complementary energy policies that expand alternative energy technologies

The Council supports several of the MAC's recommendations and is pleased with the committee's inclusion of many of the Council's market-based recommendations in the draft report. The following comments address recommendations on specific sections of the draft report.

Options for Program Scope

In designing the scope of California's cap-and-trade program, the Council recommends that the MAC consider the need for a successful market that is broad and comprehensive enough to be effective at finding the least cost reductions. Of the four options outlined by the MAC, the size of the market would need to be at least the size of Program 3.¹

First-Seller Approach

The Council is exploring the concept of the "first-seller approach" recommended by the MAC and is interested in receiving further analysis on this approach. In particular, we believe stakeholders would benefit from additional discussion to further define the "first-seller" category (e.g., would this approach cover utilities, power marketers, CA-ISO, others?). The Council recommends that in selecting an approach, that California pursue a model that will put it in the strongest position to serve as a regional/national model for other cap-and-trade programs and to link easily with an international system.

Allocation and Auction

The Council supports the MAC's recommendation that a portion of the allowance value created through an auction under a cap-and-trade program should be available for investments in end-use efficiency improvements and technology R&D.²

Allocation: The Council agrees with the MAC's recommendation that by basing allocation methods on performance, value will be provided to energy efficiency, renewables and cleaner generation. The Council strongly supports an output-based methodology that would distribute allowances based on the amount of electricity, not on the amount of fuel used or historic emissions. With this focus on output over emissions, energy efficiency, carbon efficiency and cleaner generation sources – including renewable energy – are directly encouraged. The Council recommends a fuel-neutral, updating, output-based allocation. Output-based policies send a clear signal to the marketplace – lower-carbon emitting energy options receive direct, clear, consistent and bankable value.

¹ Draft Report, Program 3, p. 29.

² Draft Report, Summary of Recommendations, p. 51.

Auction: The Council supports a large-scale direct allocation; however, should California continue to consider an auction, we recommend the use of a mixed allowance/auction approach with a phase-in period for the auction to minimize possible dramatic economic impacts that a large-scale auction might have on affected sources in the initial phases of the program. Further, should an auction be pursued, the Council strongly recommends the targeted use of auction revenue to reduce program costs by driving clean energy technology investment and deployment, consistent with the MAC's recommendation that California use a portion of the allowance value created under a cap-and-trade program to promote investment in low-greenhouse gas technologies and fuels, including energy efficiency.³

Recognition for Early Action

The Council strongly supports the MAC's recommendation that the cap-and-trade program should be designed to promote early action, recognizing early investments in greenhouse gas reductions.⁴ Rewarding emission reductions that occur in advance of the enactment of the program has the potential to generate economic and environmental benefits, as well as hasten clean energy technology deployment. The Council encourages CARB to adopt a simple and transparent credit for early action program to ensure robust participation by interested companies. Further, the Council urges the MAC to consider an early action program that may include offsets from other regulatory offset schemes and/or high-quality voluntary schemes.⁵

Offsets

The Council supports the MAC's recommendation to use offsets in California's cap-and-trade program.⁶ This will provide compliance flexibility and will lower compliance costs and encourage technology innovation and deployment. The creation of an offset program will have a secondary benefit by creating a standardized currency for voluntary greenhouse gas credit trading. Non-capped sectors will have the opportunity to participate in creating additional reductions beyond levels set by AB 32.

As noted by the MAC, the Council agrees that the offset program will need to be carefully designed to maintain integrity and ensure that offsets are real, additional, independently verifiable, permanent, enforceable and transparent.⁷ However, in developing standards for additionality, the Council wishes to reiterate its caution against the use of pure financial additionality tests in determining offset project eligibility. Financial additionality can be part of a range of factors, but it should not be the only way of proving additionality, nor should it be weighted more than other additionality tests. In our experience, financial additionality tests alone deter good projects and weaken the credibility and market power of offset programs. Further, financial additionality tests are subject to gaming and cannot reasonably account for market behavior. Instead, we recommend practical application of a number of "barriers tests," as is recommended by the World Resource Institute's Greenhouse Gas Protocol for Project Accounting.⁸

The Council supports the MAC's recommendation of using a standards-based offsets program in lieu of a case-by-case review of individual offsets projects, which has caused issues with efficiency and consistency in the case law approach used by the Clean Development Mechanism.

³ Draft Report, Summary of Recommendations, p. 56.

⁴ Draft Report, Section 6.2, p. 56.

⁵ Early action programs such as those supported by state public utility commissions and other regulatory agencies (i.e., The Climate Trust in Oregon).

⁶ Draft Report, Section 6.3, p. 58.

⁷ Draft Report, Section 6.3.2, p. 59.

⁸ See the WRI Greenhouse Gas Protocol for Project Accounting at:

http://www.ghgprotocol.org/DocRoot/m1Tv5lnUuFTjYZx3x1ev/GHG_Project_Protocol.pdf

Further, the Council supports the MAC's recommendation that the offset program categories should be able to evolve over time, consistent with other cap-and-trade offset programs, such as the Regional Greenhouse Gas Initiative.⁹

Lastly, the Council supports the MAC's rejection of geographic or quantitative restraints on offset projects in the California cap-and-trade program.¹⁰

Linkages

The Council supports the MAC's recommendation to link California's greenhouse gas program with other compatible regional, national and international cap-and-trade programs to ensure lowest-cost compliance and increase global market liquidity.¹¹ The Council supports strong linkages between California's program and the European Union Emissions Trading System and the Regional Greenhouse Gas Initiative, as outlined in the draft report, provided such linkages are based on comparable environmental commodities, and based on allowance transactions that are transparent and verifiable.

Conclusion

Thank you again for the opportunity to provide comment on the Market Advisory Committee's draft report on recommendations for designing a greenhouse gas cap-and-trade system for California. As outlined above, the Council supports many of the market-based design elements set forth in the MAC's draft report and strongly encourages your consideration of the Council's additional recommendations for inclusion in your final report to CARB.

If you have any questions or comments please feel free to contact me at (202) 785-0507 or via email at ljacobson@bcse.org.

Sincerely,



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⁹ Draft Report, Section 6.3.2, p. 59.

¹⁰ Draft Report, Summary of Recommendations, p. 61.

¹¹ Draft Report, Section 6.5, p. 64.